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LEGEND

X =

Y =

Year =

State =

Dear :

This letter responds to your letter dated August 24, 2007, and subsequent correspondence, submitted on behalf of X, requesting a ruling concerning the qualifying income exception to the publicly traded partnership rules of § 7704 of the Internal Revenue Code.

FACTS

X is a limited partnership organized in Year under the laws of State. X intends to sell limited partnership interests in an initial public offering after which units of limited partnership interest in X will be traded on an established securities market. After the initial public offering, X will be a “publicly traded partnership” within the meaning of § 7704(b). Y is the general partner of X and is a limited liability company, classified as a partnership for federal tax purposes. Y was organized in Year under the laws of State.

X intends to purchase operating power plants which would be fueled by geothermal steam, natural gas, coal, wood chips derived from timber, and a refined product of crude oil. The electrical energy produced by these power plants will be sold

by X to a local electric distribution utility near each power plant. Substantially more than 90 percent of X's gross income will come from the sale of electrical energy produced by these power plants.

The geothermal power plant being reviewed for potential purchase by X produces, transports, processes and markets geothermal energy by producing geothermal steam from wells drilled for that purpose and transporting the geothermal steam from the well head to a nearby generating building. In the generating building, geothermal steam drives a turbine whose mechanical energy produces electricity in a generator. Electricity so produced is delivered by electrical transmission lines owned by the power plant to an interconnection point with the local electric distribution utility. Electrical energy is sold by the power plant to the local electric distribution utility at this point. X proposes to lease the land containing the geothermal steam wells and the generating building and to buy the geothermal power plant, which includes the wells, piping from wells to the generating building, the generating building that includes the turbine, generator and ancillary equipment and the local transmission lines for connection to the distribution utility. X would buy and operate the geothermal power plant and sell its electrical energy output to a local electric distribution utility.

The natural gas-fired power plants, which X is reviewing for potential purchase, have the natural gas fuel delivered either from a major natural gas pipeline or delivered from the pipeline of the local natural gas distribution utility. All of the natural gas fired plants X is reviewing are combined-cycle gas turbine power plants consisting of a gas compressor, fuel combustors, two gas expansion turbine generators and a heat recovery steam generator to capture heat from the gas turbine exhaust. Air is compressed in the gas compressor. Energy is added to the compressed air by combusting gaseous or liquid fuel in the combustor. The hot, compressed air is expanded through the gas turbine. The gas turbine drives both the compressor and an electric power generator. Steam produced in the heat recovery steam generators powers a steam turbine generator to produce additional electric power. Distillate fuel oil, a refined product of crude oil, can be used as a backup fuel and is expected to be used at one of the plants at times of high natural gas heating demand during very cold periods in winter. X would buy and operate the natural gas fueled power plants and sell their electrical energy output to local electric distribution utilities.

The wood chip (derived from timber) power plant under consideration for purchase by X consists of a wood chip storage yard, wood chip handling and delivery equipment, a combustion boiler and a steam turbine and electrical generator. The plant buys wood chips of the appropriate size for burning in the combustion boiler under a long-term contract with a company that chips whole southern pine logs from forests near the power plant. Wood chips are delivered to the plant by truck. X would buy no wood chips except those produced from timber. Natural gas is used to start the combustion which is then sustained on the heat generated by burning wood chips. Natural gas can also be used as a backup fuel in case of wood supply interruptions.

Wood chips are burned in the combustion chamber and the heat produces steam in the boiler. Steam so produced drives a steam turbine generator which produces electricity. X would buy and operate the wood chip fueled power plant and sell its electrical energy output to a local electric distribution utility.

At the coal-fired power plant being considered for purchase by X, coal is delivered by both dedicated trains and barges. Coal is stored both in an exterior yard and an enclosed storage facility. Raw coal chunks are first crushed and then fed into the pulverizer along with air heated by the boiler. The powdered coal from the pulverizer is directly blown to a burner in the boiler. The burner mixes the powdered coal in the air suspension with additional pre-heated combustion air and forces it out of a nozzle and it is burned in the combustion chamber. The hot combustion gases enter the boiler to heat the water filled pipes and produce steam that is used to spin turbines to generate electricity. X would buy and operate the coal-fired power plant and sell its electrical energy output to a local electric distribution utility.

X requests a ruling that its income derived from the sale of electrical energy produced at power plants fueled by geothermal energy, natural gas, wood chips derived from timber, refined oil products or coal is qualifying income under § 7704(d)(1)(E).

LAW

Section 7704(a) provides that a publicly traded partnership shall be treated as a corporation. Section 7704(b) provides that the term “publicly traded partnership” means any partnership if (1) interests in that partnership are traded on an established securities market, or (2) interests in that partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

Section 7704(c)(1) provides that § 7704(a) shall not apply to any publicly traded partnership for any taxable year if such partnership met the gross income requirements of § 7704(c)(2) for such taxable year and each preceding taxable year beginning after December 31, 1987, during which the partnership (or any predecessor) was in existence.

Section 7704(c)(2) provides that a partnership meets the gross income requirements of § 7704(c) for any taxable year if 90 percent or more of the gross income of such partnership for such taxable year is qualifying income.

Section 7704(d)(1)(E) provides that the term qualifying income means income or gains derived from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy or timber) (the “Natural Resources Exception”). For purposes of § 7704(d)(1)(E), the term “mineral or natural resource” means any product of a character with respect to

which a deduction for depletion is allowable under § 611; except that such term shall not include any product described in § 613(b)(7)(A) or (B) (namely soil, sod, dirt, turf, water, mosses, minerals from sea water, the air, or similar inexhaustible sources).

The Conference Report accompanying the Revenue Act of 1987, in discussing the type of qualifying income described in § 7704(d)(1)(E), states as follows:

Income and gains from certain activities with respect to minerals or natural resources are treated as passive-type income. Specifically, natural resources include fertilizer, geothermal energy, and timber, as well as oil, gas or products thereof. For this purpose, oil, gas, or products thereof means gasoline, kerosene, number 2 fuel oil, refined lubricating oils, diesel fuel, methane, butane, propane, and similar products which are recovered from petroleum refineries or field facilities. Oil, gas, or products thereof are not intended to encompass oil or gas products that are produced by additional processing beyond that of petroleum refineries or field facilities, such as plastics or similar petroleum derivatives.

H.R.Rep. No. 495, 100th Cong., 1st Sess. 947 (1987), 1987-3 C.B. 946-947.

The Senate Report accompanying the Technical and Miscellaneous Revenue Act of 1988 states:

Natural Resources. – The bill clarifies the definition of income qualifying under the 90 percent requirement from certain activities with respect to a mineral or natural resource. For this purpose, a mineral or natural resource means any product of a character with respect to which a deduction for depletion is allowable under section 611, and also includes fertilizer. Such qualifying income does not include, for example, income from fishing, farming (including the cultivation of fruits or nuts), or from hydroelectric, solar, wind, or nuclear power production.

The reference in the bill to products for which a depletion deduction is allowed is intended only to identify the minerals or natural resources and not to identify what income from them is treated as qualifying income. Consequently, whether income is taken into account in determining percentage depletion under section 613 does not necessarily determine whether such income is qualifying income under section 7704(d).

....

With respect to marketing of minerals and natural resources (e.g., oil and gas and products thereof), the Committee intends that qualifying income be income from marketing at the level of exploration, development, processing or refining the mineral or natural resource. By contrast, income from marketing minerals and natural resources to end users at the retail level is not intended to be qualifying income. For example, income from retail marketing with respect to refined petroleum products (e.g., gas station operations) is not intended to be treated as qualifying income.

S.Rep. No. 445, 100th Cong., 2nd Sess. 424 (1988).

ANALYSIS

The issue is whether X's income from the sale of electrical energy produced at power plants fueled by geothermal energy, natural gas, wood chips derived from timber, refined oil products, and coal is qualifying income within the meaning of § 7704(d)(1)(E). The Natural Resources Exception of § 7704(d)(1)(E) provides that the term "qualifying income" means income or gains derived from, among other things, the processing or the marketing of any mineral or natural resource.

The conversion of a mineral or natural resource into electrical energy is not processing within the meaning of § 7704(d)(1)(E), and does not give rise to qualifying income. The § 7704(d)(1)(E) legislative history suggests a definition of processing that does not include the conversion of a substance to electrical energy. The term processing has a specific meaning in the energy industry, just as exploration, development, refining, transportation, and marketing have their specific industry meanings. The use of the term processing in the energy industry means a specific type of downstream activity encompassing refining and certain petrochemical activities, but this meaning does not include the production of electrical energy.

The marketing of electrical energy produced by converting a mineral or natural resource into electrical energy does not give rise to qualifying income. Electrical energy is not a mineral or natural resource, and income from the marketing of such energy is not qualifying income. The Conference Report states that "[o]il, gas, or products thereof are not intended to encompass oil or gas products that are produced by additional processing beyond that of petroleum refineries or field facilities, such as plastics or similar petroleum derivatives." The Conference Report indicates that the form of a mineral or natural resource may be changed so fundamentally that the resultant product is no longer a mineral or natural resource. Further, Congress explicitly excludes the processing of oil or gas products beyond that of refineries or field facilities. Since a power plant is not a refinery or field facility, it follows that "oil, gas, or products thereof," does not encompass electricity generated from oil or natural gas. The same rule by

extension must apply to other minerals or natural resources that might be used to generate electrical energy.

In its ruling request, X cites the statement in the Senate Report that “qualifying income does not include, for example, income from...hydroelectric, solar, wind, or nuclear power production.” X asserts that the Senate’s explicit disallowance of certain types of power production implies that other unnamed types of power production must give rise to qualifying income. This reading is overbroad. The Senate Report did not modify the list of activities that gave rise to qualifying income under § 7704(d)(1)(E). Rather, the Senate Report addresses the clarification to the definition of “mineral or natural resource” that was added to the flush language of § 7704(d)(1) by the 1988 Act. The flush language states that “‘mineral or natural resource’ means any product of a character with respect to which a deduction for depletion is allowable under § 611....” It goes on to exclude any product described in §§ 613(b)(7)(A) or (B), namely, soil, sod, dirt, turf, water, or mosses, minerals from sea water, the air, or similar inexhaustible resources. In explicitly excluding income from hydroelectric, solar, wind or nuclear power production, the Senate merely emphasizes that one cannot transform an inexhaustible resource into an energy resource in order to fit within the Natural Resources Exception. To the extent nuclear power is fueled with uranium (a natural resource within the meaning of § 7704), the Senate Report supports the conclusion that qualifying income does not include income from power production.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that the income to be derived by X from the sale of electrical energy produced at power plants fueled by geothermal energy, natural gas, wood chips derived from timber, refined oil products or coal is not qualifying income within the meaning of § 7704(d)(1)(E).

Except as specifically provided, no opinion is expressed or implied as to the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

/s/

James A. Quinn
Senior Counsel, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

cc: